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BOARD OF GOVERNORS

Col. John M. ("Mike") Abbott (1998-2001)
Chief Trial Attorney, U.S. Air Force
2240 B Street, Room C1
WPAFB, OH 45433
(W) 937-255-6111 x229
(F) 937-785-9570

Craig S. Clarke (1998-2001)
Deputy Chief Trial Attorney
United States Army Litigation Center
Contract Appeals Division
901 N. Stuart Street
Arlington, VA 22203-1837
(W) 703-696-1515
(F) 703-696-1535
E-mail: clarkcs@hqda.army.mil

Richard O. Duvall (1998-2001)
Holland & Knight LLP
3110 Fairview Park Drive, Suite 900
Falls Church, VA 22042
(W) 703-645-8620
(F) 703-645-8610
E-mail: rduvall@hklaw.com

Elaine A. Eder (1999-2002)
U.S. Coast Guard (G-LPL)
2100 Second Street, SW
Washington, DC 20593-0001
(W) 202-267-1544
(F) 202-267-4581
E-mail: eeder@comdl.useg.mil

David L. Fowler (1999-2002)
Raytheon Systems Company
1100 Wilson Boulevard, Suite 2000
Arlington, VA 22209
(W) 703-284-4349
(F) 703-528-3706
E-mail: dlfowler1@west.raytheon.com

Alan W.H. Gourley
Crowell & Moring
1001 Pennsylvania Ave., NW
Washington, DC 20004-2595
(W) 202-624-2561
(F) 202- 628-5116
E-mail: agourley@cromor.com

John S. Pachter (1999-2002)
Smith, Pachter, McWhorter & D'Ambrosio
8000 Towers Crescent Drive, Suite 900
Vienna, VA 22182-2700
(W) 703-847-6260
(F) 703-847-6312
E-mail: jspac@spmd.com

Raymond Saunders (2000-2003)
U.S. Army Litigation Center
Contract Appeals Division
901 N. Stuart Street
Arlington, VA 22203-1837
(W) 703-624-2561
(F) 703-
E-mail:

Paul C. Smith (2000-2003)
International Technology Corporation
2790 Mosside Boulevard
Monroeville, PA 15146-2792
(W) 412-858-3992
(F) 412-858-3997
E-mail: psmith1@itcrp.com

PRESIDENT'S   COLUMN

"Year of the Government Attorney within the BCABA"

President's Column

I would like to take this opportunity to outline for you some upcoming events of significant importance to members of the BCABA. On Tuesday, April 3, 2001 the Board of Contract Appeals Judges Association (BCAJA) will be hosting their annual seminar at the Hilton Alexandria Hotel in Alexandria, Virginia. While the BCABA and the BCAJA are different professional organizations, the Judges that comprise the BCAJA are also all honorary members of the BCABA itself. Consequently, I believe it is in the interests of both BCABA and professionalism to strongly encourage attendance by BCABA members at the BCAJA conference. The BCAJA program promises to address many pertinent topics such as: 1) AReport Card on ADR at the Boards of Contract Appeals; 2) Critical Path Method (CPM) Scheduling: Intellectual Honesty in Proving Delay; 3) The Panel Process: How the Boards Decide your Cases; and 4) The Impact of Recent Court and Board Decisions on Government Contract Law. Lunch as well as a reception immediately following the program will also be included.

On May 16, 2001 the BCABA will be co-sponsoring, along with the District of Columbia Bar Government Contracts and Litigation Section and the Federal Bar Association, the Annual Board of Contract Appeals Judges Reception. This reception will take place at the Westin Fairfax Hotel Grand Ballroom, 2100 Massachusetts Avenue, N.W., Washington, D.C. from 6:00-8:00pm. This annual event will afford our members the opportunity to socialize with Judges of the Boards of Contract Appeals in an elegant yet, relaxed atmosphere.

And last, but definitely not least, I have appointed Pete McDonald -- the BCABA President-Elect -- to chair this year's annual BCABA Program. This year, the Annual Program will take place on Wednesday, October 24, 2001 at the Crystal City Gateway Marriott. It promises to be a spectacular event – so please mark your calendars immediately.

Information on attending these events can be obtained through the BCABA's website: www. BCABAR.org or please feel free to contact my office at 703-917-8900, and we will get you the information you need to register for these upcoming events. I look forward to seeing you at all three events!

In an ongoing effort to increase our membership, I will be contacting former Gold Medal Firms, who have not renewed their BCABA membership and Chief Trial Attorneys to encourage government membership. We will be sponsoring a special

Executive Policy Forum for the Gold Medal Firms and the Gold Medal Government Teams in the coming months, so please sign your practice group or team up for Gold Medal Membership now!!

As always, I remain,

Yours in service,

James McAleese
President
BCABA

EDITOR's COLUMN

This quarter's Clause contains an informative article by Richard Duvall, Charles Gerdes, and Michelle Hertz,all of Holland and Knight LLP, on the new Federal debarment regulations. Another by Chris Yukins and David Black,also of Holland and Kniought on recent contracts cases decided by the Court of Appeals for the Federal Circuit (CAFC), and an equally valuable article on monitoring corporate internal compliance by Pete Comodeca.

Monitoring internal compliance by a corporation, as Pete points out, can be a great deal more valuable than cleaning up afterwards, and moreover, the in-house counsel who successfully pursues such a program will be much better informed than most other persons in the corporation. The main goal of conducting an internal investigation is to protect the company, and the rewards--and pitfalls--are great. Pete's article consists of two parts, the first of which is printed in this issue, with the balance coming next month

We have promised to keep you up to date on electronic practice of law as this year progresses. Susan Warshaw Ebner has promised us an article on this subject for the next issue. Susan recently chaired a brownbag luncheon at the COFC to discuss their pilot project. Susan has included a questionnaire for all practitioners, which she hopes you will fill out and return to her as soon as possible. Her address is 7413 Riverfalls Drive, Potomac,Md. 20854. In addition, there is adiscussion on electronic filing at GAO,
by Tania Calhoun.
The deadline for the Summer issue of the Clause is June 1st

Errata

Please make the following change to your 2001 BCABA Directory:

The email address for S. Jun Jin should be “jjin@smithpachter.com.”

Annual Meeting Announcement

The BCABA Annual Meeting will be held on Wednesday, October 24th at Crystal Gaetway Hotel in Crystal City, Virginia. The Crystal Gateway is the Marriott Hotel at the Metro in Crystal City. Please mark your calendars now and plan to attend.

THE FINAL RULE ON CONTRACTOR RESPONSIBILITY

Richard O. Duvall, Charles Gerdes, and Michelle D. Hertz, all of Holland and Knight

Effective January 19, 2001, the Federal Acquisition Regulation (FAR) will be amended to ensure that the federal government stops doing business with contractors who violate the law. Under this new regime, a prospective federal contractor must certify whether it has, within the past three years: (1) been convicted of a federal or state felony; (2) had an adverse judgment in a civil case brought by the United States; or (3) had an adverse administrative adjudication indicating a willful violation of law. Contracting officers must use the new regulatory framework to analyze contractor-provided information and any other "relevant, credible information" at their disposal and to make the affirmative determination of contractor responsibility required by law. By promulgating these regulations, the Federal Acquisition Regulatory Council (FAR Council) hopes that contracting officers will be better equipped to exercise their discretion in making affirmative responsibility determinations so that the Government can "improve the integrity of the contracting process, reduce the risk of fraud or noncompliance, and encourage standards of integrity and compliance with the law."

BRIEF BACKGROUND

According to the FAR Council, the need for these new regulations is demonstrated by a recent, four-year General Accounting Office (GAO) study of the top 100 federal defense contractors. The GAO study focused solely on contractor compliance with procurement laws and revealed over 100 instances of contractor convictions or post-indictment settlements resulting in over $400 million in fines and restitution. The study also revealed that contracting officers even awarded contracts to contractors with records of multiple procurement law violations. Based on this data, the FAR Council issued two Notices of Proposed Rulemaking (NPRMs) in July 1999 (64 FR 37360; 65 FR 40830) to revise the rules governing contractor responsibility. These NPRMs generated over 1800 comments from the contracting community at large.*The Final Rule, issued on December 20, 2000 (65 FR 80256), amends FAR Parts 9, 14, 15, 31, and 52, as more particularly described below.

NEW REQUIREMENTS FOR PROSPECTIVE CONTRACTORS

The new FAR requirements impose two direct changes on prospective federal contractors. First, new certification forms are required by changes to FAR 52.209-5 and FAR 52.212-3.** The new certification at 52.209-5 requires a prospective contractor to complete the following form:

The offeror . . . "has [ ] has not [ ] within the past three years, relative to tax, labor and employment, environmental, antitrust, or consumer protection laws- (1) Been convicted of a Federal or state felony (or has any Federal or state felony indictments currently pending against them); (2) Had a Federal court judgment in a civil case brought by the United States rendered against them; or (3) Had an adverse decision by a Federal administrative law judge, board or commission indicating a willful violation of law.

The change in the commercial item certification at 52.212-3 incorporates the same language.

Second, the FAR Council amended FAR 14.404-2 and 15.503 to incorporate much-needed procedural safeguards. Under these amended regulations, contracting officers must promptly notify unsuccessful bidders/offerors of a "non-responsibility" determination and expressly state the basis for any determination that results in rejection or exclusion of a bid/offer. Prospective contractors may seek independent review of adverse responsibility determinations by suing the federal agency in federal district court under the Administrative Procedure Act (APA) or by filing a bid protest with the agency, GAO, federal district court, or the United States Court of Federal Claims (COFC).

NEW REQUIREMENTS FOR CONTRACTING OFFICERS

The changes to FAR Part 9, which prescribe the contracting officer's methodology for making a "responsibility" determination, are both dramatic and essential to achieving the stated regulatory objectives. First, the new regulations mandate the use of an analytical framework that balances the prospective contractor's record of operation with the boundaries of the law as "an irreducible element of what it means . . . to have a satisfactory record of integrity and business ethics." Second, contracting officers are required to consider "all relevant credible information" about a contractor's record of compliance, even beyond the information provided by the contractor itself, giving the greatest weight to the record within the past three years. Finally, the new rule directs contracting officers to focus the responsibility assessment on identifying "repeated pervasive or significant violations of law" and to coordinate "non-responsibility" determinations with legal counsel for the procuring agency.

Prospective contractors need to understand that contracting officers must consider the information provided in its certification, as well as, credible information from any other source (including information provided by a contractor's competitors) as required by the following hierarchical framework:

Contracting officers must consider information based on the following which are listed in descending order of importance: (i) Convictions of and civil judgments . . . for- (A) Commission of fraud or a criminal offense in connection with obtaining, attempting to obtain, or performing a public (Federal, state or local) contract or subcontract; (B) Violations of Federal or state antitrust statutes relating to the submission of offers; (C) Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, or receiving stolen property; (ii) Indictments for the offenses listed in 9.104-3(c)(1)(i); and (iii) Convictions, civil judgments, adverse administrative adjudications, or indictments related to tax, labor and employment, environmental, antitrust, or consumer protection laws.
Contracting officers may also consider other relevant information such as civil or administrative complaints, if such action reflects an adjudicated determination by the agency.

FAR 9.104-3(c)(1) (paraphrased). Notably, the scope of information to be considered by the contracting officer is much broader than that provided by the prospective contractor's certification. For example, civil or administrative complaints relative to tax, labor and employment, environmental, antitrust, or consumer protection laws are not required to be revealed by the contractor certification, but are within the mandatory consideration of the contracting officer. A prospective contractor's record of compliance with foreign laws and regulations is also within the scope of the contracting officer's review.

CONCLUSION

New FAR regulations mandate that contracting officers consider all "relevant credible information" regarding a prospective contractor's past record of compliance with procurement, tax, labor and employment, environmental, antitrust, and consumer protection laws to make an affirmative determination of contractor responsibility. Contractors rejected or excluded from a contract award due to a contracting officer's determination of "non-responsibility" must be promptly notified of the adverse decision and its basis and are entitled to review by filing a protest or civil action under the APA. Unless blocked by the new administration*** or judicially overturned,**** these new regulations will become effective January 19, 2001. For more information and assistance in implementing compliance procedures responsive to these new regulations, please contact Holland & Knight LLP.

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* For a more complete summary and discussion of the initial Notice of Proposed Rule Making (NPRM), please refer to Michelle D. Hertz, What Does "Responsibility" Really Mean?,

** Note, under FAR 52.212-3, the new certification form is required only for commercial item contracts where the contract value is expected to exceed the simplified acquisition threshold.

*** Not only have defense and space industry groups appealed to President-Elect Bush to rescind the rule, Department of Defense, General Services Administration, and Environmental Protection Agency procurement officials have lobbied against implementation of the rule. Additionally, several influential senators and congressmen, including Senators Warner (R-Va.), Thompson (R-Tenn.), Nickles (R-Okla.), Hutchinson (R-Ark.) and Congressmen Davis and Moran (D-Va.), have publicly urged the President to delay implementation of or totally withdraw the rule.

**** On December 22, 2000, the U.S. Chamber of Commerce, the Business Roundtable, and several other business groups representing the manufacturing and construction communities filed suit in the United States District Court for the District of Columbia seeking to invalidate the "Blacklisting" rule as "arbitrary, capricious, an abuse of discretion, and otherwise contrary to law" and to permanently enjoin its implementation. Business Roundtable v. United States, D.D.C. No. 1:00CV3088 (D.D.C. filed Dec. 22, 2000).

RECENT US CAFC CASES REGARDING GOVERNMENT CONTRACTS

Christopher R. Yukins and David S. Black

Holland & Knight LLP

The following are summaries of government contracts cases decided by the United States Court of Appeals for the Federal Circuit during the last quarter of 2000.

Jowett, Inc. v. United States, Fed. Cir. No. 00-5021 (Dec. 13, 2000) (Opinion by Judge Dyk, joined by Senior Judge Friedman and Judge Clevenger).

This case demonstrates the limits on the application of evidence of trade usage and custom to the interpretation of a federal contract. The case also provides an important lesson for lawyers: an affidavit regarding trade usage or custom may be deemed irrelevant unless it identifies a specific term either used in or omitted from the contract that has a well-understood industry meaning that differs from its "ordinary meaning."

In 1996 the United States Army Corps of Engineers ("government") awarded a contract to the contractor to construct a three-story air-conditioned office building in Fort Belvoir, Virginia. Regarding the insulation of the building, the contract required the insulation of "supply ducts," "return air ducts," and "plenums," but excluded insulation on "return ducts within ceiling spaces," and "ceilings which form plenums." In response to a question from the contractor during a progress meeting, the government stated that the contract required the insulation of "cold-air supply ducts in ceiling spaces." The contractor insulated the cold-air supply ducts but then filed a claim for an equitable adjustment for this expense under the "Changes" clause of the contract. The contracting officer denied the contractor's claim, reasoning that the contract clearly required the insulation of the cold-air supply ducts.

The contractor appealed to the Court of Federal Claims ("COFC"), and both parties filed motions for summary judgment. In support of its motion, the contractor submitted four affidavits from executives at local construction firms stating that there was a well-established practice of not applying insulation to supply ducts in ceilings. The affidavits did not discuss the industry meaning of any particular terms used in or omitted from the contract. The COFC declined to accord any weight to these affidavits and granted the government's motion for summary judgment.

On appeal, the Federal Circuit concluded that the language of the contract clearly and unambiguously required the contractor to insulate all supply ducts.

The Court then addressed the contractor's argument that the COFC erred when it disregarded its evidence of trade usage and custom. The contractor argued that a contract is ambiguous whenever it does not reflect industry practice, and that evidence of industry practice is admissible to aid in the interpretation of the contract in such circumstances. The Court rejected this argument, reasoning that it would "enable[] industry practice to create an ambiguity, even before the language of the contract is itself analyzed to determine if an ambiguity lies within the four corners of the contract." Instead, the Court noted that evidence of trade usage or custom is admissible to show that contractual language has a meaning different from its ordinary meaning or that a term with an accepted industry meaning was omitted from the contract.

Turning to the facts of this case, the Court held that the COFC correctly rejected the contractor's affidavits. The Court reasoned that "the government can vary from the norm in the trade when contracting for goods and services" and that "affidavits describing a supposed common industry practice of not insulating air supply ducts in ceilings are simply irrelevant where the language of the contract is unambiguous on its face." In addition, the Court reasoned that "affidavits that those familiar with trade practices in the construction industry would interpret specifications differently are irrelevant, unless they identify a specific term that has a well-understood meaning in the industry and that was used in, or omitted from, the contract."

Marathon Oil Co. v. United States, Fed. Cir. No. 97-5146 (Dec. 28, 2000) (Opinion by Judge Newman, joined by Senior Judge Plager and Judge Rader).

This case was on remand from the Supreme Court following the high court's decision last year that the enactment of the Outer Banks Protection Act breached two leases between the federal government and two oil companies for the right to develop oil and gas resources of certain tracts of the outer continental shelf off the North Carolina coast. The Supreme Court had concluded that, because of the changes made by the statute, "the Government broke its promise . . . and it must give the companies their money back."

On remand, the Federal Circuit was required to decide the amount of restitution due to the two companies, which had previously paid the government approximately $78 million each in up-front "bonus" payments. The government argued that the amount of restitution should be reduced by an alleged decline in the market value of the leases due to the reduced price of oil and gas at the time of the government's breach. The Federal Circuit rejected the government's argument. Noting the principle that "a reduction in market value is irrelevant to the non-breaching party's right to restitution of the full amount paid," the Court concluded that the Supreme Court had already ruled that the two companies were entitled to a full refund of all payments previously made to the government. The Court quoted an example provided by the Supreme Court in its opinion: "If a lottery operator fails to deliver a purchased ticket, the purchaser can get his money back – whether or not he would have won the lottery."

James Giesler and Luke Coniglio v. United States, Fed. Cir. No. 00-5031, -5032 (Nov. 13, 2000) (Opinion by Judge Michel, joined by Judge Lourie and Judge Rader).

This case highlights the risk contractors face when they do not carefully review product specifications prior to submitting a bid or offer. The Federal Circuit has used this case to clarify the government's limited duty to notify contractors of errors in pre-award submissions indicating their intent to supply nonconforming goods.

In 1995, the Defense Logistics Agency ("DLA") issued a solicitation for bids to supply mixed nuts. The solicitation referred to a "Commercial Item Description" ("CID") published by the Commerce Department requiring that mixed nut composition contain no more than 10% peanuts by weight. However, the solicitation did not contain a copy of this CID, and the contractor never reviewed the CID before submitting its bid. The contractor's bid stated that it would supply mixed nuts that conformed to the CID.

Before awarding the contract, the DLA conducted a pre-award survey of the subcontractor who was going to supply the mixed nuts to the contractor. During the inspection of the subcontractor's facility, the DLA's representative did not discuss the peanut content of the subcontractor's nut mix. However, two days after the pre-award survey, the subcontractor faxed its product specification to the DLA representative stating that its proposed nut mix contained 60% peanuts. The DLA representative did not notice the discrepancy between the peanut content of the subcontractor's nut mix and the CID specification. The DLA awarded the contract to the contractor.

Soon after the award, the DLA discovered that the peanut content of the contractor's nut mix was nonconforming. The contractor attempted to renegotiate the contract, but the DLA refused. After the delivery date passed without performance, the DLA terminated the contract for default.

The contractor filed suit in the Court of Federal Claims ("COFC") seeking rescission of the contract. The government filed a counterclaim for excess reprocurement costs totaling $185,625.30. The COFC granted rescission to the contractor, reasoning that the government had constructive knowledge that the contractor intended to supply a nonconforming nut mix and had breached its duty to notify the contractor of this error.

On appeal, the Federal Circuit reversed the COFC's rescission of the contract. The Court noted the general rule that "if the government has knowledge, or constructive knowledge, that a contractor's bid is based on a mistake, and the government accepts the bid and awards the contract despite knowledge of this mistake, than a trial court may reform or rescind the contract." However, the Court emphasized that this rule is limited to "bid errors" resulting from one of three causes: (1) a clerical error, (2) an arithmetical error, or (3) a "misreading" of the specifications.

The Court rejected the contractor's argument that its proposal to deliver mixed nuts with 60% peanuts was based on a "misreading" of the contract specification. (No clerical or arithmetical error was alleged.) The Court reasoned that the contractor's failure to read the CID amounted to "gross negligence" rather than an excusable misreading of the specifications. The Court also concluded that the government's failure to attach a copy of the CID to the solicitation was of no legal moment. The contractor had the burden of obtaining the publicly available CID.

Alternatively, the contractor argued that rescission of the contract was justified due to DLA's failure to examine the pre-award fax from the subcontractor disclosing its intent to supply a nonconforming nut mix. The Court disagreed. The Court noted that, under FAR § 14.407-1, contracting officers have a duty to examine <u>bids</u> for mistakes and to notify bidders when there is reason to believe that a bid is erroneous. Taking pains to distinguish its decision in <u>United States v. Hamilton</u>, 711 F.2d 1038 (Fed. Cir. 1983), the Court reasoned that this duty to examine "does not extend to errors that may be contained in a contractor's subsequent filings." In addition, the Court stated that the regulatory duty to examine bids for errors does not require contracting officers "to identify mistakes in subcontractors' filings after the opening and verification of the prime contractor's bid." Because the contractor's bid stated that it would supply mixed nuts in conformance with the CID and made no reference to the 60% peanut content later mentioned in the subcontractor's post-bid facsimile, the Court held that DLA had breached no duty to the contractor.

Finally, the Court concluded that the government did not violate any implied duty of disclosure imposed by the "superior knowledge doctrine." This doctrine requires the government "to disclose to a contractor otherwise unavailable information regarding some novel matter affecting the contract that is vital to its performance." The Court held that the doctrine was inapplicable because the contractor had ready access to the publicly available CID specifying a nut mix containing a maximum of 10% peanuts and greater access to the fact that its subcontractor was intending to provide a nonconforming product.

Rex Systems, Inc. v. William S. Cohen, Secretary of Defense, No. 99-1527 (Fed. Cir. September 14, 2000) (Opinion by Judge Michael with Judges Lourie and Rader)

Following a termination for convenience, contractors frequently submit settlement proposals to the contracting officer regarding the costs associated with the termination. Settlement negotiations often get mired in disagreements regarding aspects of the contractor's proposal and occasionally break down altogether. In this case, the Federal Circuit clarified the circumstances that may convert frustrated settlement negotiations following a termination for convenience into a "claim" under the Contract Disputes Act ("CDA").

In 1991, the Army awarded Rex Systems, Inc. ("RSI"), a contract for the delivery of 50 computer memory assemblies. In 1992, the contracting officer notified RSI that the Army had decided to terminate the contract for convenience. In March 1993, RSI submitted a termination settlement proposal. Negotiations continued on an intermittent basis over the next two-and-a-half years until, in September 1995, the parties reached a settlement with respect to the amount due to RSI.

The parties disagreed on one point: RSI claimed it was owed interest on the settlement amount running from the submission of its initial proposal in March 1993. RSI argued that the negotiations between it and the Army had previously reached an impasse that converted its settlement proposal into a CDA claim, which started the interest clock mandated by 41 U.S.C. § 611. The contracting officer disagreed and issued a final decision denying RSI's claim for interest. The Armed Services Board of Contract Appeals ("ASBCA") likewise denied RSI's claim.

RSI appealed, and the Federal Circuit affirmed. In doing so, the Court reviewed and clarified its holding in Ellett Constr. Co. v. United States, 93 F.3d 1537 (Fed. Cir. 1996) that an "impasse" between the parties to settlement discussions converts a contractor's termination settlement proposal into a "claim" under the CDA. After reviewing the facts of Ellett and its progeny in the Court of Federal Claims, the Federal Circuit held that evidence that the parties eventually reached a settlement "is conclusive evidence that negotiations had not reached an impasse." Instead, "[o]bjective evidence that negotiations had been abandoned by the parties is necessary before the negotiations can be found to have reached an impasse." According to the Court, "[a]n impasse requires a stalemate or a break-down in negotiations. A negotiation that has truly broken down cannot ultimately result in a mutual agreement." The Court expressly noted that "[l]engthy negotiations or passage of time . . . do not alone establish an impasse, particularly when negotiations eventually succeeded."

Turning to the facts of this case, the Court held that because RSI and the Army "ultimately negotiated a settlement agreement that was apparently satisfactory to both parties," RSI had failed to show the development of an impasse. For this reason, RSI's proposal was never converted into a CDA claim entitling it to interest.

<u>Southern California Edison Co. v. United States</u>, No. 99-5074, -5075, -5076, -5077, -5089, -5090 (Fed. Cir. September 11, 2000) (Opinion by Judge Gajarsa with Judges Lourie and Linn).

In this case, the Federal Circuit carved out a new exception to the general rule that an agency's interpretations of its contracts, including incorporated regulations, made in the context of a contract dispute are subject to <u>de</u> <u>novo</u> judicial review. The Court held that an agency's interpretation of regulations incorporated into a contract are entitled to <u>deference</u> if reasonable so long as the agency has no economic interest in the outcome of the dispute.

The case involved contracts under which energy companies purchased hydroelectric energy produced at the Hoover Dam. A federal statute governing the operation of the Dam mandated that contract rates be set to repay construction, operation, and maintenance costs of the Dam during its first fifty years of operation without generating a profit for the government. Pursuant to Department of Interior regulations, the government was required to refund any revenues collected from energy companies in excess of the costs associated with the Hoover Dam project at the conclusion of the fifty-year period, which expired in 1987. These regulations were incorporated by reference into sales contracts for the purchase of energy produced by the Dam.

An accounting of revenues received from energy sales during the initial fifty-year period revealed a $25 million surplus. Interpreting its regulations regarding the return of such a surplus, the government chose a methodology for allocating this surplus among the several utilities that had energy purchase contracts. Two of the utilities were displeased with the methodology chosen by the government and filed suit in the Court of Federal Claims alleging breach of contract. The government filed third-party actions against the remaining energy companies in the event funds had to be returned for redistribution.

The Court of Federal Claims held that, although the government's choice of a methodology was entitled to deference, the methodology chosen was unreasonable. The government and the third-party defendants appealed.

The Federal Circuit reversed. After concluding that the COFC's decision was appealable and that the COFC had subject matter jurisdiction over the third-party actions, the Federal Circuit turned to the appropriate standard of review to apply to the government's interpretation of its regulations in choosing a refund methodology. The

Court noted that, under prior Federal Circuit precedent, when administrative regulations are incorporated by reference into a contract, an agency's interpretation of those regulations in the context of a contract dispute is not afforded the deference described in the seminal case of Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984). Instead, courts generally review an agency's contract interpretations, including interpretations of incorporated regulations, de novo to avoid endorsing "self-serving post-hoc reinterpretations of contracts that an agency might offer in the context of a litigation."

However, in this case, the Court held that the government's interpretation of its regulations in determining a methodology to return the surplus revenues was entitled to deference if reasonable. The Court reasoned the deferential standard of review was justified because the government "had no economic stake in the excess revenue that was to be distributed." The Court stated "there was no motivation for [the government] to adopt a self-interested regulatory interpretation because under any refund allocation method, all excess revenues would be distributed from its coffers to the customers." According to the Court, a de novo standard of review was not warranted because "the agency was acting as a neutral arbiter resolving the customers' rights to the over-collected funds, rather than as an interested party to a contract." The Federal Circuit went on to hold that the refund methodology adopted by the government was reasonable and entitled to deference.

Dow Chemical Co. v. United States, No. 97-5035, -5038 (Fed. Cir. September 6, 2000) (Opinion by Senior Judge Archer with Judges Rich and Gajarsa)

In this case, the Federal Circuit addressed the nature of a contractor's remedy when the government repudiates a contract.

In the early 1970's, Dow Chemical Co. ("Dow") licensed to the United States Bureau of Mines a patented process for filling abandoned mines in order to prevent the collapse of the overlying land. In 1978, the government refused to pay any royalties under the license claiming that it was not using Dow's invention or, alternatively, that Dow's patent was invalid. In 1983, Dow filed an action claiming patent infringement and breach of license. In 1985, Dow formally terminated its license with the government.

In a series of opinions, the Court of Federal Claims ("COFC") held that Dow's patent was valid and that the government infringed by utilizing Dow's mine-filling process without paying royalties. The COFC also held the government repudiated its license with Dow when it unequivocally stated in writing that it would not pay royalties. The COFC held that this repudiation had the effect of voiding the license *ab initio* so that the measure of damages was based on unlicensed infringement rather than breach of contract.

On appeal, the Federal Circuit held that Dow's patent was valid but that the COFC's construction of it was erroneous. After construing the scope of the claims in

Dow's patent, the Court remanded the case to the COFC for a determination of whether any infringement occurred.

Turning to the breach of license claim, the Federal Circuit affirmed the COFC's finding that the government repudiated the license but reversed the COFC's conclusion that the contractor was entitled to rescission of the license. The Court noted that rescission, which "has the effect of voiding a contract from its inception, i.e., as if it never existed," is an "equitable doctrine . . . grounded on mutual mistake, fraud, or illegality in the formation of a contract." The Court concluded that Dow had not alleged "any such defects that would allow Dow to rescind the license, rendering it void *ab initio*."

Moreover, the Court reasoned that because rescission is an equitable remedy, "it will not ordinarily be invoked where money damages – in this case damages for breach of contract – will adequately compensate a party to the contract." Because Dow did not show that contract damages were inadequate, the COFC erred when it rescinded the licenses between Dow and the government. As such, to the extent the COFC concluded on remand that the government infringed Dow's patent, Dow would be entitled to only contract damages for infringements occurring before it terminated the license in 1985. Thereafter, damages would be measured by 28 U.S.C. § 1498.

The Court also rejected the government's argument that Dow had waived its right to terminate the license by waiting over seven years to do so after the government's repudiation. The Court noted that, following a repudiation or material breach of a contract, the non-defaulting party has an election to either terminate the contract or to continue performance, and that the right to terminate is not waived unless (1) the breaching party has changed its position in reliance on the non-defaulting party's failure to terminate, or (2) the non-defaulting party's conduct is such that it would be unjust to allow him to change his position. Because neither of these circumstances had occurred in the seven years between the government's repudiation of the license and Dow's termination, the Court ruled that Dow did not waive its right to elect termination.

Freightliner Corp. v. Louis Caldera, Secretary of the Army, No. 99-1217 (Fed. Cir. September 6, 2000) (Opinion by Judge Gajarsa with Chief Judge Mayer and Judge Schall).

In this case, the Federal Circuit held that neither FAR § 17.207(f) nor DAR § 1-1502(e) creates a cause of action for contractors to remedy a contracting officer's violation when exercising an option.

In 1984, the Army's Tank-Automobile Command ("TACOM") awarded a five-year contract to Freightliner Corp. for the purchase of small emplacement excavator vehicles. In the fifth year of the contract, TACOM exercised an option to order additional vehicles. Freightliner requested an equitable adjustment, claiming that the contracting officer's modification was an ineffective exercise of the contract's option provision. Both the contracting officer and the Armed Services Board of Contract Appeals ("ASBCA") denied Freightliner's claim.

On appeal, Freightliner argued that it was entitled to an equitable adjustment because the contracting officer failed to comply with both FAR § 17.207(f) and DAR § 1-1502(e) when exercising the option to purchase more vehicles. The Federal Circuit rejected this argument, holding that neither regulation created a cause of action for Freightliner even if the contracting officer committed a violation because neither regulation existed for the benefit of private contractors. In addition, the Federal Circuit held that the option order complied with the quantity, delivery, and price terms of the contract's option provision.

Ace-Federal Reporters, Inc. v. Barram, No. 99-1258 (Fed. Cir. Sept. 28, 2000) (Opinion by Chief Judge Mayer, joined by Judges Michel and Schall).

Historically, it has been difficult for contractors to recover lost profits in claims against the federal government. Although lost profits are a standard element of damages in commercial disputes, in federal contracting the courts (and boards of contract appeals) have been extremely reluctant to award lost profits.

The decision in Ace-Federal may help to change all that, and open the door to recovery of lost profits. The contract that underlay Ace-Federal was for court reporter services. The contract was a "requirements" contract, which meant that the covered agencies had to funnel all of their requirements for court reporting services through the six court reporting companies under contract.

In practice, however, frustrated government attorneys ordered court-reporting services outside the contracts, from other companies. That, the Court concluded, constituted a breach of the requirements contracts, and entitled the contractors to damages for their lost profits.

The Court cited a Court of Claims case 40 years old, Locke v. United States, 283 F.2d 521 (Ct. Cl. 1960), to award lost profits. Reaching past decades of precedents that have held lost profits too speculative to award in government contracts cases, the Federal Circuit held that, per Locke, so long as there is a "reasonable probability" of finding lost profits, they should be awarded.

The Federal Circuit also rejected the government's argument that the rogue orders outside the contracts constituted, in effect, partial terminations for convenience. The Court disparaged the doctrine of partial terminations for convenience – the "fiction," as the Court put it, that when the government cuts back its ordering under a contract, it is "partially terminating" the contract for its convenience. The Court did not kill the doctrine of partial terminations for convenience but indicated that the government will not be able to raise the doctrine as a shield against a claim for lost profits.

Kinetic Builder's, Inc. v. Secretary of the Air Force, No. 00-1065 (Fed. Cir. Sept. 25, 2000) (Opinion by Judge Linn, with Judges Rader and Schall).

Government contracts tend to generate multiple, overlapping claims. Those claims may make their way through the disputes process – through the contracting officer, a board of contract appeals or the Court of Federal Claims, and then the Federal Circuit – at very different speeds. In Kinetic, the Court ruled that claims from the same contract may be appeals to the Federal Circuit on a piecemeal basis, so long as the different claims focus on different or unrelated sets of operative facts, and issues of liability and quantum (damages) have been resolved on the claim to be appealed to the Federal Circuit.

The Court's decision in Kinetic also clarified issues in federal construction contracting law. The Court made it clear, for example, that "substantial completion" occurs only when "the promisee has obtained, for all intents and purposes, all the benefits it reasonably anticipated receiving under the contract." The Court also once again addressed the elements of a delay claim, and emphasized that the claimed delay must indeed fall on a project's critical path.

Secretary of the Navy v. AEC Corporation, Fed. Cir. No. 99-1343 (Sept. 25, 2000) (Opinion by Judge Bryson, with Judges Michel and Gajarsa)

Before the government terminates a contract for default, generally the government must send a warning – a "cure notice." The Federal Circuit's decision in AEC Corporation emphasized that when the contractor receives such a warning, the contractor must – by word and deed – give the government adequate assurances that the contractor will be able to perform. If the contractor fails to do so, the government may terminate the contract for default.

The Navy awarded AEC a contract to complete construction of a Naval and Marine Corps Reserve Training Center in Miami. When AEC fell behind schedule, the parties agreed to extend the original completion date from October 14, 1990, to April 27, 1991. In February 1991, AEC's surety froze the project's bank account and AEC began pulling workers from the project.

On March 20, 1991, the Navy issued a cure notice expressing its concern that AEC "would not be able to complete the project by April 27." The cure notice stated that the Navy would consider terminating the contract for default unless AEC cured its failure to diligently pursue completion within ten days.

AEC responded to the cure notice in two letters. The first letter, dated April 3, 1991, stated that the actions of AEC's surety and changes imposed by the Navy "not only prevent[ed] AEC from meeting its April 27, 1991 completion date, [they have] made it impossible for AEC to predict an ultimate completion date at this time." After the Navy asked for an explanation of the contract changes that allegedly impeded AEC's progress, AEC stated in a second letter dated April 5 that it:

> cannot cure the deficiency stated in your Cure Notice due to the restrictions that [the surety and its affiliate] have imposed on the

disbursement of funds from the joint escrow account. Consequently we cannot give you any assurance as to when the project will be completed.

AEC subsequently reduced its work force on the job site to two supervisory employees and informed the Navy of this action. After AEC failed to respond to a show cause letter issued on April 9 and failed to augment its substantially reduced workforce at the site, the Navy terminated the contract for default on April 22, 1991.

AEC appealed the Navy's decision, and the Armed Services Board of Contract Appeals ("ASBCA") held that the default termination was invalid. The ASBCA rejected the Navy's contention that AEC's failure to give assurances in response to the cure notice justified the default termination.

The Navy appealed, and the Federal Circuit reversed the ASBCA. The Federal Circuit held that AEC's deficient response to the March 20 cure notice justified the Navy's conclusion that there was no reasonable likelihood AEC would complete construction on time. The Federal Circuit reasoned that AEC's April 3 and April 5 letters in response to the cure notice were inadequate because they "offered nothing to allay the Navy's concerns about AEC's ability to complete the contract on a timely basis." The Court also reasoned that AEC's actions at the work site — reducing its personnel, removing contract files and office equipment, and disconnecting its telephone — "clearly failed to provide the requisite assurances that AEC would complete the project on a timely basis." Ultimately, the Court reasoned that AEC's response to the cure notice was deficient because it "offered the Navy no reason to believe that those difficulties would be resolved any time in the near future."

CORPORATE INTERNAL INVESTIGATIONS

PETER J. COMODECA, ESQ.
CALFEE,HALTER&GRISWOLD,LLP

I. INTRODUCTION

In today's legal climate, executives and directors of companies must be more concerned than ever before about the threat that litigation against the company poses to their organization's stability and profitability. Recent years have evidenced a proliferation of allegations against companies, involving topics as diverse as racially discriminatory hiring and promotion; theft; fraud; sexual harassment; and securities law violations, for which both the government and private parties have sought to hold corporations accountable, either for failing to detect problems or failing to adequately remedy them once discovered. The litigation and governmental investigations that took place in the highly publicized Texaco and Daiwa matters only serve to illustrate the massive exposure corporations can face when they fail to take adequate measures to prevent or investigate misconduct by their employees.[1] These cases also demonstrate how corporations can exacerbate their problems by not taking prompt action to cooperate with authorities upon discovering a problem.

The importance of conducting internal investigations in a proper manner became even more critical, and more complicated, earlier this year when the scope of corporations' duties to disclose information gathered during an investigation was substantially affected by a letter opinion issued by the Federal Trade Commission (FTC). The FTC held that corporations are under a duty to disclose to the <u>subject</u> of their investigation the entirety of all information and results gathered during an investigation. The FTC based its rationale on the amendments to the Fair Credit Reporting Act ("FRCA"),[2] finding that such investigative information constitutes a "consumer report" which must be provided to employees when the information is used in making employment decisions including promotion or termination.

The FCRA applies when employers seek "consumer reports" from a "credit reporting agency" for use in making employment-related decisions. The FCRA provisions have most typically been applied where an employer contacts a credit bureau for a background check on a prospective employee. Under the FCRA, the employer must notify the employee of its intention to obtain the information, and obtain the employee's permission. If the information the employer obtains affects its decision, the employer must share the information with the prospective employee and provide the employee the opportunity to rebut the data.[3]

Section 603(f) of the FCRA defines a "consumer reporting agency" as any person paid to assemble or evaluate credit or other information on consumers for the purpose of regularly furnishing consumer reports to third parties. Section 603(d)(1)

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[1] These matters have been among the most widely publicized actions brought against corporations in recent years. The differences of each industry, and the nature of the wrongdoing, illustrate the potential pitfalls any corporation can face. The aftermaths of each controversy also demonstrate the extent to which corporations do, and do not, learn from their mistakes.

In September 1995, U.S. and Japanese regulators learned that Toshide Iguchi, a former executive in the New York office of Daiwa Bank in the firm's bond trading department, had engaged in over 30,000 unauthorized trades over an 11-year period. Worse for Daiwa, U.S. government authorities also discovered that Daiwa had failed to promptly inform them of the trading irregularities. The damage to Daiwa by Iguchi's activities, which resulted in a $1.1 billion loss to the bank, was only further compounded when the firm settled with U.S. regulators in February 1996, agreeing to pay a fine of $340 million and to halt all its activities in the United States. Daiwa subsequently sold its U.S. operations to a competitor, Sumitomo Bank, and in Japan, regulators ordered Daiwa to cut its overseas assets by half and curtail its trust banking business. Additionally, executives of Daiwa Bank's U.S. operations pled guilty to criminal charges stemming from their efforts to hide the trading losses from U.S. regulators.

Texaco's legal problems were front page news for much of 1996 when a group of black employees brought a class-action lawsuit against the corporation for racial discrimination in hiring and promotion. The case, which featured a taped racist exchange among top executives that also included talk of destroying evidence, resulted in Texaco's payment of $140 million in damages and an additional $35 million to establish a task force to make improvements and monitor the company's progress in hiring and promoting minority employees.

The aftermath of these two matters is also illustrative of the right, and wrong, way for corporations to move forward from such experiences. In 1998, Daiwa Securities, another branch of the Daiwa corporate family, agreed to pay a $100,000 fine and $590,000 in restitution to settle allegations it overcharged U.S. customers who utilized their services to trade securities on Japanese stock exchanges. By contrast, at Texaco in 1998, minorities constituted nearly 40% of new hires and 20% of promotions at the company, and Texaco was confident enough to apply for inclusion in <u>Fortune</u> Magazine's 1999 list of America's Best 50 Companies for Asians, Blacks and Hispanics.

[2] 15 U.S.C.A. §1681, *et. seq.*
[3] 15 U.S.C.A. §§ 1681b, 1682g.

defines a "consumer report" as one which contains information concerning an individual's "character, general reputation, personal characteristics, or mode of living" that may be used as a factor in determining eligibility for employment or in deciding whether to take disciplinary action.[4] Slightly different, but also relevant to the law affecting internal investigations, is the "investigative consumer report", defined by Section 603(e) as a consumer report that includes information obtained during interviews with "neighbors, friends or associates of the consumer."[5]

In early 1999, Judi Vail, a management attorney in Colorado, sent an inquiry letter to the Federal Trade Commission, seeking guidance upon whether the FCRA applied to workplace investigations of sexual harassment allegations, which are required on the part of the employer by Title VII of the Civil Rights Act of 1964. Ms. Vail noted that if the allegations were substantiated by the investigation, the corrective or disciplinary action taken against the employee could constitute "adverse action" under the FCRA.

The FTC legal counsel's office, through the form of an FTC Letter Opinion, concurred with Ms. Vail's assessment of "adverse action", and went on to examine whether the investigation constituted a "consumer report" to which the employee has the right to obtain a copy. According to the staff attorney who issued the letter opinion, the relevant inquiry in this determination is <u>not</u> whether the scope of the investigation goes beyond the employer's internal documents. Rather, the central issue is whether the outside agent retained by the corporation "assembles or evaluates" information for furnishing "consumer reports" as those terms are defined under the FCRA.[6]

According to the letter opinion, outside organizations retained by a corporation to assist in the investigation of harassment claims become Consumer Reporting Agencies as defined under the FCRA by providing a "consumer report" to a "third party," the employer.[7] Indeed, the FTC letter opines, such a report is "likely" to constitute an "investigative consumer report" under §603(3) if the report will contain information from interviews with other employees, or other "associates", concerning the target's reputation or characteristics.[8]

The opinion letter goes on to inform Ms. Vail that, because such reports constitute either a consumer report or an investigative consumer report under the FCRA, employers must comply with the FCRA requirements requiring employers to notify employees of the investigation and/or provide a copy of the report to the target.[9] Furthermore, the opinion letter states that the information contained in the report may not be redacted, building upon an earlier staff opinion letter finding that an employer who uses investigative consumer reports must comply fully with the provision of the FCRA applicable to both consumer reports and investigative consumer reports.[10]

The recent Letter Opinion issued by the FTC further complicates the task of corporate executives charged with keeping their companies from becoming embroiled

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[4] 15 U.S.C.A §1681a.
[5] Id.
[6] Christopher W. Keller, FTC Letter Opinion on Sexual Harassment Investigations and the Fair Credit Reporting Act, 96 DLR E-1 (April 5, 1999).
[7] Id.
[8] Id.
[9] Id.
[10] Id.

in costly and distracting litigation arising from the misdeeds of their employees. This article will analyze the two essential elements of corporate risk management which, if properly utilized, can prevent employees from engaging in conduct which could damage the company, or minimize the corporation's exposure when misconduct does come to light. The two essential elements are corporate compliance programs intended to prevent potential problems and internal investigations undertaken when such problems are discovered. Guidelines will be presented for implementing an effective corporate compliance program, as well as for conducting effective internal investigations. Methods aimed at ensuring investigation results are accorded the maximum possible degree of confidentiality, and the lowest possible risk of accidental disclosure, will be examined as well as the crucial issue of determining when corporations should disclose the investigation results to outside parties and the government. Finally, the Federal Trade Commission letter opinion will be discussed, with consideration given as to how corporations should modify the manner in which they conduct internal investigations in light of the opinion.

II. CORPORATE COMPLIANCE PROGRAMS - A MUST

Although increasing numbers of corporations in recent years have instituted compliance programs as "preventative medicine" designed to stop activities which could potentially lead to litigation, many companies have yet to put such procedures into place. Reasons for this omission often include the added costs, administrative complications, difficulties of implementation and possible effect upon employee morale such programs entail. However, there are a number of reasons why risk management prevention officers and other top executives of corporations should consider implementing such a program, despite the initial burdens of establishing such programs.

A. In The Long Run, Compliance Programs Save Money

First and foremost, a properly designed and implemented compliance program enables the corporation to detect misconduct at an early stage and take necessary corrective action before the problem becomes so widespread or severe that litigation and/or adverse publicity is inevitable. A well-designed corporate compliance program enables a corporation to act quickly, and either contain the problem or minimize the adverse consequences caused by it. Second, despite the misgivings corporate officials may have about the cost of implementing a compliance program, a well reasoned and utilized system will, over time, prove to be a cost saving device. By enacting a corporate compliance program which prevents or quickly detects errors or misconduct, a company can avoid the far greater costs of criminal or administrative fines, civil damage awards, or settlements of civil suits and/or shareholder derivative suits. Additionally, corporations face the potential prospect of losing business opportunities due to their debarment or suspension from certain government programs because of misconduct or poor performance at the company, as well as decreased sales caused by the damage done to the company's reputation by way of bad publicity. Finally, the legal fees the corporation must expend in defending actions that may have been prevented by a compliance program are often substantial.

A good corporate compliance program aids companies in avoiding "soft costs" which, although not readily apparent on the books, nevertheless may constitute a significant potential drain on the bottom line. Such soft costs include lost employee productivity, disruption of the company's business operations, decreased employee work rate, and loss of employee morale. Heightened scrutiny by government agencies, and the attendant disruption of the company's operations, can be avoided with a good compliance program. Indeed, even where a problem is detected too late to avoid civil litigation or governmental scrutiny, the fact that a corporation already had in place a bona fide compliance program at the time the incident occurred assists the company in demonstrating its commitment to preventing misconduct, leading to a lower risk that corporate executives may be held civilly or criminally liable for failing to prevent the misconduct. Under the U.S. Sentencing Commission Guidelines Manual,[11] an in-place compliance program can operate to reduce the liability of the company.

B. To Work, the Program Must be Effective

In order for a corporation to garner all the benefits a corporate compliance program can provide, the program must be sufficiently rigorous to reflect the Company's due diligence in attempting to prevent misconduct. A program riddled with flaws and loopholes in the supervisory framework will be of minimal benefit to the company's defense in the event that litigation occurs. Indeed, such a program may actually harm the corporation by further demonstrating the corporation's malfeasance or negligence.

In order to ensure that a corporate compliance program is effective, and that the existence of the program will aid the company, corporate compliance officials must establish reasonable compliance standards and procedures capable of eliminating or reducing the frequency and severity of adverse activity. One common method of introducing a compliance program includes the creation of either a Code of Conduct or a compliance manual to be acknowledged and followed by all company employees. Such a manual should include the purpose of the program, identification of compliance officers, a method of contacting the compliance officers, and an identification of disciplinary measures. The purpose section should specify, to the extent possible, all procedures and requirements to be complied with throughout each segment or function of the organization. Corporate officers at the highest level should be permanently assigned to oversee compliance and a clear chain of command and communication amongst compliance officials should be established and stated in the manual. However, the provision of a manual to corporate employees is not sufficient in and of itself. In addition to the preparation and distribution of the corporate compliance manual, the firm's compliance officers must make efforts to effectively communicate the procedures and standards contained in the manual to all employees. Strong consideration should be given to a training program in which the standards, procedures and code of conduct are explained in detail to the employees, and any questions answered. This can be further refined by additional section or division specific training as necessary.

In conjunction with creating and distributing rigorous compliance standards and procedures, corporations must also engage in meaningful self-regulation. Compliance measures, such as monitoring, auditing and reporting systems designed to detect unauthorized or improper activity, must be implemented to ensure information is channeled to the appropriate compliance officer(s). As part of this system, employees should be permitted to report allegations to corporate compliance officers confidentially without having to speak to their supervisors first. Furthermore, a corporate compliance

[11] Hereinafter "USSG", as amended, November 1998.

system is most effective if employees believe it is backed up by management and a credible deterrent. Any disciplinary measures identified in the corporate compliance manual should be enforced in a uniform manner, without favoritism. Consideration should be given to outlining the procedure available in the program to permit input and response by the target of any investigation. Any actions taken against an employee should be documented in detail, clearly stating the circumstances of the misconduct, the manner of the investigation, and the nature of disciplinary action taken against the employee. Finally, when misconduct is discovered, steps should be taken to prevent similar incidents in the future. Each year the compliance program should be reviewed and modified as necessary to incorporate available changes or improvements, and to remove any flaws in the program, which have become apparent.

III. INTERNAL INVESTIGATIONS - INTRODUCTION

Despite a corporation's best efforts to prevent misconduct through a well-reasoned and properly implemented compliance program, problems nevertheless will occur. Under such circumstances, the corporation should engage in a thorough investigation of the situation in order to ascertain what actually occurred, assess the corporation's potential liability because of the misconduct, and consider appropriate corrective measures. As with the implementation of a corporate compliance program, conducting an internal investigation implicates many of the same concerns of expense, disruption of corporate activities and potential damage to employee morale. However, there are compelling reasons for a corporation to conduct its own internal investigation upon becoming aware of a problem. Although not every crisis results in civil litigation or a governmental investigation, a corporation will be remiss if it fails to initiate a proper investigation and be fully versed in the facts before outside parties become aware of the problem. There are a number of potential benefits a corporation receives from a properly conducted internal investigation, as well as reasons why such an investigation must be undertaken.

A. When Should a Company Investigate?

There are situations in which a corporation may be <u>required</u> to perform an investigation. These include investigations pursuant to either an agreement reached between the corporation and the government or required by the terms of a state or federal statute. Examples include businesses subject to governmental regulation, such as the securities industry. Also, governmental regulatory bodies and/or self-regulating organizations ("SROs") may require corporations to conduct internal audits designed to detect misconduct.[12]

[12] See, e.g., Rule 3010(a) of the National Association of Securities Dealers (NASD) Manual, which states: Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of this Association. Final responsibility for proper supervision shall rest with the member...

B. Benefits of a Bona Fide Investigation - The Organizational Sentencing Guidelines (OSG).

A second benefit of a properly performed internal investigation is that once completed, the results may aid the corporation and its officials named as defendants in governmental or civil litigation in avoiding or mitigating criminal punishment and/or civil penalties.[13]

According to the Commentary to United States Sentencing Guideline (USSG) § 8A1.2, "the hallmark of an effective program...is that the organization exercised due diligence in seeking to prevent and detect criminal conduct,". The Commentary defines "due diligence" as the corporation, at a minimum, having taken the following steps:

1. The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct;

2. Specific individual(s) within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures;

3. The organization must have used due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities;

4. The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, e.g., by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required;

5. The organization must have taken reasonable steps to achieve compliance with its standards, e.g., by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution;

6. The standards must have been consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense. Adequate discipline of individuals responsible for an offense

[13] United States Sentencing Guidelines (USSG); USSG §8A1.2, Commentary, recognized a competent investigation procedure as an "effective program to prevent and detect violations of law," which is defined as one "that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct."

is a necessary component of enforcement; however, the form of discipline that will be appropriate is case specific; and

7. After an offense has been detected, the organization must have taken all reasonable steps to respond appropriately to the offense and to prevent further similar offenses-including any necessary modifications to its program to prevent and detect violations of law.

U.S. Sentencing Commission guidelines provide organizational defendants with a significant opportunity to mitigate their exposure to criminal fines through self-reporting of misconduct, or by assisting the government in furthering its investigation. The fine reduction formula set forth in the Organizational Sentencing Guidelines ("OSG") section of the USSG creates clear incentives for corporations to engage in desirable conduct, regardless of the nature of the corporation's past offenses. Under the OSG, companies are rewarded for their cooperation through a percentage reduction of recommended fines. In fact, voluntary disclosure and cooperation by the corporation will produce the greatest fine reductions for the most serious offenses.[14]

The OSG have three principal objectives. First, to equalize sentences imposed upon corporations in all federal courts. Second, to deter corporate wrong doing. Third, to provide restitution to victims.[15] Additionally, the OSG are structured to provide incentives for organizations to establish and maintain internal mechanisms for preventing, detecting and reporting criminal conduct by rewarding a corporate offender with more lenient treatment, if, at the time of the offense, it had in place an "effective program to prevent and detect violations of the law."[16] Due to the fact that severe penalties have been imposed upon noncooperating corporate wrongdoers, these so-called "incentives" have the practical effect of being de facto requirements for most corporations. Corporate officials should be aware that the sentencing guidelines have shifted significant discretion regarding the target corporation and the severity of the recommended criminal penalties from the courts to the prosecutors. Thus, the ability of a corporation to achieve a favorable decision concerning the imposition of criminal penalties depends heavily upon the corporation's willingness to assist the government in its investigation.[17] By conducting a preliminary investigation, the corporation both

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[14] USSG §8C2.6 sets forth minimum and maximum fine multipliers by which fines imposed upon a company can be increased or decreased, from a maximum quadrupling the penalty, to reducing it to .05 of the original fine. The multiplication factor applied is based upon the corporation's "culpability score", which is determined through the application of a range of factors set forth in USSG §8C2.5. Among the mitigating factors listed are both an "Effective Program to Prevent and Detect Violations of Law" described in detail in footnote ___, supra. Additionally, where a corporation engages in "Self-Reporting, Cooperation, and Acceptance of Responsibility," this can also lead to a reduction in the sentence. Where the corporation has engaged in both activities, and has not committed any aggravating offenses, this can lead to between a 60% and 80% reduction in the size of the fine.

[15] Donna Gill, 1993 *General Counsel Survey: Organizational Sentencing Guidelines*, CHICAGO LAWYER, Nov. 1993, at 1.

[16] USSG, Guidelines Manual, Ch. 8, Introductory Commentary.

[17] USSG §8C2.5, Commentary (n. 11), notes that for a corporation to get credit for self-reporting and cooperation under the Guidelines, the cooperation it provides must be timely, which the Commentary defines as, "begin[ning] essentially at the same time the organization is officially notified of a criminal investigation," and thorough, which the Commentary defines as including, "disclosure of all pertinent information known by the organization." According to the Commission, a "prime test" of whether the

demonstrates its good faith and significantly eases the burden upon the prosecutor conducting any subsequent investigation, which should translate into more lenient treatment.

Securities industry investigations serve to illustrate these general principles. In recent years, the SEC has displayed a "carrot and stick" approach to internal investigation, by which penalties imposed upon corporations for violations of federal securities laws will be increased or decreased by the Commission based upon the target company's efforts to promptly initiate internal investigations at the first sign of wrongdoing, and to cooperate subsequently with any outside investigation performed by federal agencies. This has resulted in the SEC "rewarding" companies with lower sanctions when they have promptly initiated internal investigations and granted the SEC access to the results. Conversely, the SEC has taken the step of imposing harsher penalties on those corporations that fail to take such actions.[18]

A third major benefit that inures to corporations which take the initiative in investigating misconduct is that performing an internal investigation allows the company to maintain a measure of control over the process. If the corporation does a thorough investigation at the outset, the government may feel that further inquiry is not warranted and may further decide against extending the inquiry or expanding it to other topics. Additionally, internal investigations can play an important role in a corporation's assessment of the effectiveness of its internal controls and risk management measures. Furthermore, internal investigations have the concrete benefit of allowing a corporation to promptly and accurately assess the extent of (1) its civil exposure and (2) the likelihood of avoiding legal proceedings. Internal investigations are also invaluable in helping a company prepare for and/or minimize the impact of any subsequent litigation. Thus, companies are able to assess at an early stage in the process the validity of the civil claims which may potentially exist, affording the company the opportunity to resolve the litigation before expending unnecessary legal fees. Finally, an investigation can also put the corporation in a better position to defend against other similarly situated potential plaintiffs.

C. Possible Risks

This is not to say that internal investigations conducted by a corporation are without risk. Information the corporation discovers during the investigation may identify a previously undiscovered problem which the corporation may then have to act affirmatively to resolve to avoid civil or criminal liability. The investigation may uncover documents and other materials that an outside party may later be able to obtain by subpoena or other discovery methods during subsequent litigation. Because there is no Fifth Amendment protection accorded to corporations, any nonprivileged documents within a company's files created pursuant to the investigation must be produced upon demand by the government. Production of these non-privileged materials, which may include the names of witnesses spoken to, the types of documents reviewed and other

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organization has disclosed all pertinent information is "whether the information is sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible for the criminal conduct."

[18] Anne C. Flannery and Jennifer S. Milano, *Protection of Internal Corporate Investigation Materials Under the Attorney-Client Privilege and Work Product Doctrine*, METRO. CORP. COUNS. December 1997, at 7.

such items, can serve as a virtual road map for either the government or private plaintiffs in their own inquiries. Finally, disclosures of material and information discovered during an investigation may result in a waiver of the corporation's right to resist production of these same documents in any subsequent litigation.

IV. THE EFFECTIVE INTERNAL INVESTIGATION

Despite the obvious risks, the benefits of a good investigation are clear. However, to perform an investigation properly requires considerable foresight and planning in the initial stages in order to ensure success. There should exist in the corporation a generic policy identifying the general steps to be considered when conducting an internal investigation. Before any investigation process begins, an incident specific memo should be created setting forth the investigative procedures to be followed, including suggested methods to be used in order to identify and review relevant documents, to identify and interview witnesses, and to maintain confidentiality over the investigation while it is being conducted. Steps should be taken to afford the memo privileged status to avoid disclosure.

A. Goals of the Investigation

In conducting an internal investigation, the corporation should keep in mind three paramount goals. First and foremost is the goal of accuracy. Inaccurate information can be extremely damaging and can call into question the credibility of the entire investigation. This in turn, can heighten the risk that outside parties or the government may commence their own separate investigations of the corporation's affairs.

The second central goal should be thoroughness. Incomplete information can also damage the corporation's credibility. An incomplete investigation also puts the corporation at risk that additional damaging information may come to light at a later date for which the corporation has not taken corrective action or prepared a defense. Furthermore, an investigation which is not thorough can lead to miscalculations of defense costs. This in turn may result in an ill-advised litigation strategy. An incomplete investigation may also result in insufficient reserves being set aside to cover any potential loss, resulting in further financial injury.

The third central goal of the corporation in conducting an internal investigation is promptness. Long drawn out investigations inevitably compromise any realistic expectation of confidentiality. Additionally, an investigation which is not conducted in a timely manner may prompt the government to initiate an investigation before the results are available from the corporation's internal reviews. This generally will result in inconsistent findings. Failure to engage in a prompt investigation also demonstrates the corporation's lack of commitment to its internal compliance program.

B. Mechanics of the Investigation

In order to maximize confidentiality, the investigation <u>always</u> should be conducted by attorneys. As discussed below, the benefits to the corporation opting to employ legal counsel to conduct an investigation are significant. However, at the time the decision is made to employ attorneys to conduct the review, several steps must be taken.

1. Pre-Investigation Preparation

First, the corporation must decide whether to employ outside legal counsel or permit attorneys employed by the company to conduct the investigation. For several reasons, it is preferable that the attorneys performing the investigation be independent outside counsel, rather than in-house counsel. First, retaining outside lawyers lends a measure of independence and objectivity to the investigation. This may benefit the company if the investigation is reviewed by the government and/or third parties to assess the accuracy of the investigation or to determine whether further inquiry is warranted. Additionally, if the corporation decides to allow in-house counsel to conduct the investigation, company executives face the daunting task of ensuring the conduct of the investigation is kept as distinct as possible from the attorneys' other functions, particularly those of a non-legal nature such as management or administration.

Should the corporation make the decision to retain outside counsel, at the outset of the representation several steps must be taken before the investigation actually begins. First, the nature and purpose of the engagement should be made explicit in an agreement and the engagement should not cover any other legal issues. It should be made plain that the attorney(s) are being retained in order to conduct an investigation in order to be able to render legal advice concerning the matter involved and to prepare for possible litigation, and not to report facts and render business services. This distinction is crucial in ensuring the greatest likelihood that the results of the investigation will be protected from involuntary disclosure to outside parties or the government during discovery in any subsequent investigation or litigation. If outside counsel is retained, they should also be authorized by management to retain the services of any other outside counsel or experts they may find necessary. Any such additional parties should be retained directly by the attorneys, through explicit agreements setting forth the purpose, nature and scope of their work.

2. Document Review

Once the scope and nature of the representation is defined, counsel will commence the internal investigation by pursuing two distinct but equally important core tasks: document review and employee interviews. The importance and extent of these core tasks will vary according to the subject being investigated. The document review is generally undertaken prior to employee interviews. This allows the attorneys to identify people to be interviewed and facilitates more informed interviews. It also allows investigators access to information that witnesses may otherwise be unwilling or unable, due to their position, to provide. It is extremely important that the document review be as thorough as possible to minimize future surprises and to permit the corporation to predict the spectrum of investigative results by outside parties should they occur. During the document review, documents protected by privilege are to be identified and separated from nonprivileged items. The source of each relevant document should be identified and noted, including the author, recipients, and the location from which the document came from, including identification of the file, if applicable. Because it may become necessary at a later date to respond to a subpoena, counsel should proceed on the assumption that the documents will have to be produced to the government or civil litigants at a later date. Finally, and perhaps most crucially, the corporation's established document destruction procedures should be suspended during the course of the investigation, or at a minimum, extreme care should be taken to insure that documents relating to the investigation are not destroyed. This step is essential to defeat any future allegations of spoliation of evidence or obstruction of justice.

3. Employee Interviews

After of the document review is completed, counsel should then commence the process of interviewing all employees involved in the incident. However, before the interviews commence, investigating counsel should evaluate the risks associated with dual representation of the corporation and employees and decide whether or not it is proper to represent the employees individually. Dual representation presents the risk that counsel may be constrained from disclosing to the company the substance of communications with the employee. It can also raise other conflict issues involving the attorney/client relationship, such as situations in which counsel learns that the employee has violated the law in the scope of their employment. For these reasons, investigating counsel should generally not simultaneously represent employees and their employer.

Before beginning an employee interview, counsel should advise the employee of several things. If dual representation has been determined to be inappropriate, counsel should advise the employee that the attorney represents the company and that the attorney is not representing the employee.[19] This will prevent a court from determining at a later date that it may have been reasonable for the employee to believe that he was represented by counsel at the time he or she was interviewed. Counsel should also inform the employee that the information provided during the interview is confidential, will be maintained in confidential files, and should not be discussed with anyone else, but that it is ultimately for the corporation or for the law to determine whether the information will be disclosed to any third party at a later date. Finally, the attorney should make explicit that the interview is being conducted for the purpose of gathering factual information in order to provide the corporation with legal advice in anticipation of litigation. This statement further immunizes information gathered from the risk of disclosure to outside parties by cloaking it with the attorney/client privilege.[20]

C. Maximizing Confidentiality During the Process

One of the most important considerations for both the corporation and its attorneys, whether retained as outside counsel or employed by the corporation, is the importance of maximizing the confidentiality accorded to the results of the interviews.

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[19] Outside counsel should be aware that some legal commentators contend that employees must also be advised at the outset of an interview, where corporate counsel is not representing the employee as an individual, the employee has the right to retain their own lawyer and may refuse to speak with the company's lawyers until consulting with their personal counsel. However, existing case law does not appear to require corporate counsel to provide such warnings to the employee.

[20] See, e.g., Upjohn v. United States, 449 U. S. 383, 101 S. Ct. 677, 66 L. Ed.2d 584 (1981) (attorney-client privilege applies to communications by any corporate employee regardless of position when the communications concern matters within the scope of the employee's corporate duties and the employee is aware that the information is being provided to enable the attorney to provide legal advice to the corporation); Admiral Ins. Co. v. U. S. D. C., Dist. Ariz, 881 F.2d 1486 (9th Cir. 1988) (statement made by corporate party's officer to corporation's counsel to enable counsel to provide legal counsel to corporation concerning potential liability in anticipated litigation was within attorney-client privilege, despite contention officer was no longer an employee at the time of the statement due to corporation's plan to terminate him following interview).

Although corporate officials, in consultation with their legal counsel, may subsequently decide to disclose the information to the government or outside parties, inadvertent disclosure before the corporation is prepared can be potentially devastating. In this regard, two important privileges exist which may serve to immunize interview results from subsequent disclosure to outside parties unless and until the corporation chooses to do so: the attorney/client privilege and the attorney work product doctrine.

1. Attorney/Client Privilege

The attorney/client privilege is a legal principle with ancient roots in Anglo-American common law, dating back at least as early as the reign of Elizabeth I; it has long been recognized as the "oldest of the privileges for confidential communications known to the common law."[21] The privilege belongs to the client of an attorney, and enables the client to refuse to disclose, and to prevent any other person from disclosing, confidential communications between the client and the attorney under certain circumstances.[22]

The attorney/client privilege applies to in-house counsel as well as outside counsel, but courts may scrutinize more closely an assertion of privilege relating to communications between in-house lawyers and management. Additionally, investigating counsel should be aware that courts will not recognize the privilege when an attorney is acting merely as a business advisor, rather than performing distinct legal functions or preparing for possible litigation.[23] Thus, it is critical to specify at the outset of the process that investigating counsel's role in collecting and reviewing documents and conducting employee interviews is to perform legal functions and/or prepare for possible litigation, because for a particular communication to be privileged, it must be primarily or predominantly of a legal character. It is essential that investigating counsel not commingle in the same document or conversation legal advice related to the investigation with other advice. The critical inquiry in this regard is whether the lawyer's communications, viewed in their full context and content, were made in order to render legal advice or services to the client.[24] Additionally, corporations should be aware that the privilege protects only the attorney/client communication, and not the underlying pre-existing facts, from disclosure. Thus, corporations cannot hide damaging information merely by communicating with their attorneys about it.

2. Attorney Work Product Doctrine

The attorney work product doctrine differs from the attorney client privilege in several respects and offers additional protection to the products of an internal investigation. The work product doctrine is not a privilege, but rather a qualified immunity protecting from discovery documents and tangible things prepared by an

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[21] 8 J. WIGMORE, EVIDENCE §2290 (McNaughton rev. ed. 1961).

[22] BLACK'S LAW DICTIONARY 129 (6TH ed. 1990).

[23] FED. R. CIV. P. 26(b)(3), Advisory Committee Note; U. S. v. Adlman, 134 F.3d 1194 at 1202 (2d Cir. 1998); Boca Investigating Partnership v. U. S., 31 F. Supp. 2d 9 (D.DC 1998).

[24] See, e.g., Motley v. Marathon Oil Co., 71 F.3d 1547 (10th Cir. 1995) (memorandum by in-house counsel regarding guidelines for work force reductions was prepared for purpose of giving legal advice, and fell within attorney-client privilege, where counsel stated memorandum contained legal advice to the company and that he did not render business advice in the document.

attorney in anticipation of litigation.[25] The doctrine thus protects against the disclosure of an attorney's mental impressions, conclusions, opinions, or legal theories. However, the doctrine will only protect those materials that are prepared in anticipation of litigation.[26] Furthermore, the litigation for which the documents were created must be a real possibility at the time the documents were created; a remote possibility of litigation is insufficient to warrant the granting of the work product privilege to items created by the attorney.[27] However, an investigation by a federal agency presents more than a "remote" prospect of future litigation, thus providing reasonable grounds for the protection afforded by the work product doctrine.[28]

3. Ensuring Continued Confidentiality

In order to maximize the applicability of the attorney/client privilege and attorney work product doctrine to those items created or gathered by investigating counsel, the attorney and the corporate client should take several steps. As discussed above, the retention and/or written authorization provided to the counsel from the corporation should state that the counsel has been retained to assess possible legal problems and risks, rather than to conduct a purely factual inquiry. The letter should also make clear that the purpose of the investigation is to provide legal advice in preparation for possible litigation. The engagement letter should identify particular business practices that are preliminarily thought to raise potential regulatory issues, should refer to prior incidents that may have raised legal issues and liabilities, and should refer to the possibility of implementing changes in business practices to avoid future legal problems. Additionally, the engagement letter should identify as the goals of the investigation the rendering of legal advice, the issue of properly satisfying the regulatory criteria governing the matter being investigated and the distinction, to the extent possible, of counsel's tasks from any purely business objectives resulting from the investigation. This facilitates the treatment of documents created during the investigation by counsel as confidential. While documents prepared for both litigation and business purposes will generally be protected by the work product doctrine, documents created irrespective of litigation are not protected and it is often difficult to determine where that line is drawn.[29] The safest way to assure that the protection of the work product privilege is accorded to documents is to include the attorney's legal theories, opinions and mental impressions throughout their notes and memoranda. In this regard, care should be taken not to merely write down the interviewee's answers verbatim, but to include at the same time counsel's mental impressions and opinions of that testimony as it is provided.

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[25] FED. R. CIV. P. 26(b)(3); National Union Fire Ins. Co. v. Murray Sheet Metal Co., Inc., 967 F.2d 980 (4th Cir. 1992) (pure work product of attorney, insofar as it contains mental impressions, conclusions, opinions or legal theories concerning litigation, is immune from discovery to same extent as attorney-client communication).

[26] FED. R. CIV. P. 26(b)(3)

[27] Upjohn, supra, note 19; Gould v. Mitsui Mining & Smelting Co., Ltd., 825 F.2d 676, 680 (2d Cir. 1987) (work product rule requires the existence of a real, rather speculative, concern).

[28] Pacamore Bearings Incorporated v. The Minebea Co., Ltd., 918 F.Supp. 491(D. N.H. 1996).

[29] See, e.g. U. S. v. Millman, 822 F.2d 305 (2d Cir. 1987) (taxpayer failed to sustain burden of showing documents sought by IRS were related to taxpayer's status as attorney, rather than his status as business advisor and accountant); U. S. Adlman, 134 F.3d 1194 (2d Cir. 1998) (document created because of anticipated litigation does not lose work-product protection merely because it is intended to assist in making business decision; where document was created because of anticipated litigation, and would not have been prepared but for that anticipation, it falls within work-product protection).

Once the initial scope and purpose of the investigation is determined, the investigating counsel can then take several other steps to enhance the confidentiality of the investigation. As few non-attorneys as possible should be involved in conducting the investigation. Investigating counsel should limit dissemination of confidential material as much as possible to reduce the risk of an inadvertent waiver of privilege through accidental disclosure of confidential materials. When copies of materials relating to the investigation are distributed, they should only be provided to members of the investigation team and members of senior management who have a specific need to see the documents. Prior to document disclosure to proper recipients, all documents should be marked clearly with the warning "do not duplicate" and to the extent applicable "attorney-client privilege, do not release to third-parties". Before a decision is made by the corporation and its counsel to disclose privileged documents to a governmental agency, the company should attempt to extract an agreement from the government that the disclosure is confidential and does not constitute a waiver of any applicable privileges. Additionally, in the event confidential materials must be produced in connection with litigation, the production should be made pursuant to either a stipulation not to further disclose or a protective order entered upon an adequate finding of good cause by the court. Similarly, any documents given to a third party should be pursuant to a confidentiality agreement that assures that the materials are not forwarded to other persons. In case of production to a government entity, additional agreements should be reached minimizing the chance of further disclosure pursuant to a Freedom of Information Act, or similar state statute sanctioned, request.

4.Waiver of Confidentiality

Investigating counsel must be extremely wary of engaging in conduct, or allowing others to engage in conduct, which could cause a waiver of the applicable privileges accorded the investigation materials. Investigating counsel should make all corporate employees aware that any voluntary disclosure to a third party by the client will generally result in a waiver of the protection accorded by the privileges. When the privilege is lost, the materials disclosed are no longer confidential and third parties may be entitled to obtain the items in subsequent requests.

When such items are released to a governmental agency, it is unclear whether this course of action effects a waiver of the attorney/client privilege and/or the attorney work-product doctrine. The courts have provided various responses to this issue and no unified approach has emerged.

The majority of federal courts that have addressed the privilege issue have determined that, where a corporation makes a voluntary disclosure to a governmental agency of documents, memoranda or other information in response to an inquiry, this action waives the attorney-client privilege and work-product protection accorded to the materials, making them subject to discovery by outside parties in subsequent litigation. Leading advocates of this approach are the United States Courts of Appeal for the District of Columbia, Second and Third Circuits.

In Permian Corp. v. U.S.,[30] the Court of Appeals for the District of Columbia dealt with the issue of whether a corporation, having disclosed documents to one federal agency, may block a subsequent disclosure of those documents to another agency conducting a separate investigation. Permian had disclosed documents to the

[30] 665 F.2d 1214 (D.C. Cir. 1981)

SEC in response to an investigative inquiry and argued that attorney-client privilege prevented the SEC from turning over the documents to the Department of Energy, based on an agreement by the SEC that it would not disclose the privileged information to any third party. The court rejected this argument, finding that the corporation's disclosure had waived the attorney client privilege. The ruling did, however, uphold the lower court's ruling that the work-product doctrine protection had not been waived. However, the appellate court subsequently held in In re Subpoena Duces Tecum[31] that a corporation's voluntary disclosure to the SEC of documents protected by the work-product doctrine did in fact waive the protection of the doctrine when different plaintiffs subsequently sought the production of the items in a shareholder civil suit. The Court distinguished its holding from that in Permian by noting that in the earlier decision, the corporation had disclosed the documents only after obtaining a stipulation with the opposing party and a judicial protective order, whereas in Subpoenas, the corporate disclosure had been subject to the SEC Voluntary Disclosure Program and no special provision had been made to maintain the documents' confidentiality. Thus, in that federal circuit, unconditional, voluntary disclosure of privileged materials constitutes a complete waiver of all applicable protections, and third parties may obtain the information in subsequent litigation.

The Court of Appeals for the Third Circuit has adopted an even more expansive interpretation of the waiver doctrine. In Westinghouse Electric Corp. v. Republic of the Philippines,[32] the corporation had been subjected to investigations by the SEC and Department of Justice (DOJ) of allegations that the corporation had bribed Ferdinand Marcos in order to win a nuclear power plant contract. In response to these inquiries, Westinghouse provided each agency the results of the corporation's own internal investigation, which had been conducted by outside counsel. After Marcos's ouster, the Phillipines brought suit against Westinghouse seeking production of the documents and information Westinghouse provided to the federal agencies. Westinghouse argued that those materials remained protected by attorney-client privilege and the attorney work-product doctrine, but the federal magistrate overseeing the case, the District Court and the Third Circuit all found that the corporation's prior disclosure had effected a waiver of both the attorney-client privilege and the attorney work-product doctrine, thus making the documents available to adversaries in subsequent litigation. Similarly, the Court of Appeals for the Second Circuit in In Re Steinhardt Partners, L.P.[33] held that Steinhardt, who had been the subject of an SEC investigation, had waived the protection afforded a legal memo by the attorney work-product doctrine by submitting it to the SEC in an effort to avoid disciplinary action by the Commission; when plaintiffs in subsequent civil litigation alleging fraud sought the production of the memorandum, the court held that they were entitled to its production.

The Court of Appeal for the Fourth Circuit has taken perhaps the most expansive view of the waiver doctrine of any of the federal courts. The case of In Re Martin Marietta Corporation [34] involved an investigation of fraud charges by the Department of Defense. In response, Marietta submitted a document, which included

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[31] 738 F.2d 1367 (D.C. Cir. 1984)
[32] 951 F.2d 1414 (3d. Cir. 1991).
[33] 9 F.3d 230 (2d Cir. 1993).
[34] 856 F.2d 619 (4th Cir. 1988).

information gathered during the company's internal investigation, detailing why the corporation should not be prosecuted and the parties agreed that the submission of the document would not effect a waiver of any applicable privileges. Marietta eventually settled with the Department of Defense. Subsequently, an employee was indicted for the same activities, and sought production of the document, which the corporation resisted.

The court rejected Marietta's claims of attorney-client privilege and attorney-work product doctrine. The court applied the implied waiver rule to find that corporations effect a waiver of the protection accorded to any documents disclosed to the government, even if such disclosures occur in the context of a settlement conference. More problematic is that the Court went on to hold that Marietta had also waived the attorney-client privilege and attorney work product doctrine protections that applied to all non-opinion documents referenced in the subject memorandum. Thus, Marietta was required to produce all additional materials in its possession on the same topics referenced in the memorandum. By finding that the waiver of privilege for one document obligates a corporation to make full and complete disclosure of all related materials to both the government and outside third parties, including items it never intended to disclose, the Fourth Circuit has taken a position which has the potential for severely weakening incentives for corporations to voluntarily and fully comply with governmental investigations. To date, however, the Fourth Circuit's expansive approach to the waiver issue has not been adopted by other federal courts.

In contrast to other courts, the Court of Appeals for the Eighth Circuit has applied what has become known as the "limited" or "selective" waiver doctrine. First developed in Diversified Services Industries, Inc. v. Meredith, [35] the court held that when a company voluntarily discloses privileged information to a government agency, it has waived the protection of the privilege as to that particular agency, but that the privilege remains intact in the event outside parties seek disclosure of the privileged materials in a later matter. In Diversified Services, the corporation had voluntarily disclosed to the SEC materials collected during an internal investigation, including interviews of corporate employees conducted by outside counsel. When a plaintiff in subsequent litigation sought to force the corporation to produce the information disclosed to the SEC, the corporation refused, citing attorney-client privilege. The Court of Appeals, overruling the trial judge, found that the corporation's actions in voluntarily surrendering the materials the SEC pursuant to an agency subpoena had not waived the attorney-client privilege with respect to the materials sought by the Plaintiff in the later action. Instead, the court held, Diversified's actions had only created a "limited waiver" of the privilege, reasoning that to find otherwise might inhibit corporations from employing outside counsel to investigate and advise companies when wrongdoing comes to light. Unfortunately, the reasoning of the Eighth Circuit in Diversified Services has since been rejected by the Second, Third, Fourth and District of Columbia Circuits.

5. Voluntary Waiver

Corporate counsel should be aware that in criminal investigations, the government, with increasing frequency, has requested corporations to voluntarily waive the privilege accorded to documents gathered pursuant to internal investigations in order to assist the government's efforts. The U.S. Attorney's office for the Southern District of

[35] 572 F.2d 596 (8^{th} Cir. 1978).

New York is a strong proponent of this approach, and expects corporations to waive applicable privileges, and warns that failing to do so will be evaluated in determining whether the company has been sufficiently cooperative enough to avoid indictment or a more severe sentence under the Organizational Sentence Guidelines.[36]

Despite the benefits enjoyed by corporations that act properly to preserve the attorney/client and attorney/work product privileges accorded to documents, notes, memoranda and records related to an internal investigation, voluntary disclosure is not without its merits in some circumstances. By disclosing the results of an internal investigation, a corporation has the opportunity to place the misconduct in the best possible light, assert any applicable defenses and present any mitigating circumstances, as well as work to control the initial "spin" given to the matter by the press. Furthermore, voluntary disclosure may persuade the government to forego criminal and/or civil proceedings, especially if the corporation has taken remedial action in light of the results of its investigation. In the event prosecution is unavoidable, proper voluntary disclosure will still afford the corporation the possibility of more lenient treatment under the Organizational Sentencing Guidelines.

Corporations that do business with governmental entities who advocate voluntary disclosure of internal investigation results should be aware that a number of different agencies maintain their own voluntary disclosure programs including the Department of Defense, Department of Health and Human Services, and the Antitrust Division of the Department of Justice. Agency specific disclosure programs offer a method by which a corporation that discovers wrongdoing may either avoid criminal prosecution or obtain lenient treatment.[37]

There are, however, risks and disadvantages associated with voluntary disclosure. It can lead to criminal prosecution for wrongdoing that may not have otherwise been discovered by the government. It may alert the government to additional or unrelated wrongdoing which prompts it to take further action. It also risks generating adverse publicity resulting in unanticipated injury to the business.

Once the corporation has decided to disclose the results of an internal investigation to the government, it faces additional issues. First, it must decide how to structure its disclosure. A limited disclosure may only pique the government's interest and prompt it to seek additional information. An overly extensive disclosure may result in an unnecessary waiver of privilege. The company's good faith may also become an issue based on the nature of the disclosure. Additionally, the corporation's disclosure may lead to an inquiry into areas not originally expected by the corporation. Thus, the decision is essentially a balancing test in which the corporation must weigh the advantages and disadvantages of disclosure on a case by case basis, considering such factors as the seriousness and extent of the wrongdoing and the risk of independent discovery by the government.

Finally, corporate officers should be aware that under certain circumstances, disclosure of internal investigation results is indeed required by statute,

[36] Robert G. Morvillo, *The Decline of the Attorney-Client Privilege*, N.Y.L.J., December 2, 1997 at 3.

[37] For example, the Department of Defense in 1986 established the Voluntary Disclosure Program to encourage disclosure of fraudulent activities by contractors working on projects for the Department. When a contractor qualifies for the program, the Department of Defense will advise the Department of Justice that the corporation has cooperated and is taking corrective measures. However, the government will not guarantee immunity from prosecution. Similarly, the Antitrust Division of the Department of Justice revised its policy in 1997 to reassure corporations that voluntary disclosure of anticompetitive violations will not, in many instances, result in criminal charges.

and therefore prompt disclosure will avoid compounding the corporation's legal difficulties. One of the prime examples of disclosure mandated by statute is found in the securities industry. Securities and Exchange Commission regulations, for example, require public companies to disclose legal proceedings concerning officers, directors and nominees, and to disclose whether an officer, director or nominee has ever been found by a court, the SEC, or the FTC, to have violated any state or federal securities or federal commodities law where such finding has not been reversed, suspended or vacated.[38] However, recent court cases suggest that formal, criminal proceedings must be instituted against the individual before disclosure is required. The Second Circuit so held in U.S. v. Matthews,[39] and relying upon the Matthews decision, the U.S. District Court for the District of Columbia in U.S. v. Crop Growers[40] held that Item 401(f) does not require disclosure of allegations of criminal conduct that have not resulted in charges being filed.

IV. CONCLUSION

It is virtually impossible for corporations to prevent an employee from engaging in activities for which the organization could be found culpable if the employee is determined to take part in misconduct. However, a properly designed and rigorously enforced compliance program helps ensure that employees are made fully aware of the types of activities which are impermissible, thereby decreasing the frequency of inadvertent misconduct borne of ignorance of employee conduct standards. Furthermore, a corporation which institutes a well thought out compliance program will provide itself a greater opportunity to act quickly to contain problems soon after they arise, resolving them through internal channels before they achieve crisis status. Also, a compliance program properly followed provides the corporation with the opportunity to mitigate the result of any misconduct. Although the initial costs associated with designing and implementing a compliance program are not inconsiderable, they are far lower than the damage which can be caused when employee misconduct comes to light pursuant to government investigation, third-party litigation, or bad publicity.

Even the most diligently implemented corporate compliance program may not be able to prevent or resolve all employee misconduct. However, to contain any potential damage, the corporation must perform a thorough investigation. For an investigation to be successful and for a corporation to garner the benefits an investigation may provide in deflecting later criticism of the company, care must be taken in planning and implementing the process. An essential part of this is ensuring that the investigation process, and the results of the investigation, are provided as much confidentiality as possible. A company that loses control of the investigative process because of inadvertent, premature disclosure loses the benefits the investigation can provide. This may result in greater damage to the organization. In order to maximize the investigation's confidentiality, the corporation must ensure the process is cloaked with the protection of the attorney client privilege and the attorney work product doctrine. Attorneys, whether employees of the corporation or outside counsel retained for the

[38] See, e.g., Item 401(f) of SEC Regulation S-K, which requires corporate disclosure of certain types of past and pending criminal and civil proceedings against officers, directors, and persons nominated to serve on the board of directors, where the proceedings "are material to an evaluation of the ability or integrity" of the individual. 17 C.F.R. §229.401(f) (1994).

[39] 787 F.2d 38 (2d Cir. 1986).

[40] 954 F.Supp. 335 (D.DC 1997).

investigation, should direct and conduct the investigation at each stage. From the initial engagement of counsel to the compilation of a final report, it should be clear that the attorneys conducting the investigation are doing so for the purpose of rendering legal advice to the company. By doing so, this will increase the probability that the corporation will be able to control the "if" and "when" of public disclosure and the findings and results of the internal investigation.

Despite a corporation's instinct to avoid having to disclose damaging information, in a number of different industries, such as securities broker-dealers and contractors working with the government, disclosure is mandated by law. Additionally, the Opinion Letter issued by the FTC may have added an additional disclosure requirement for corporations: the duty to disclose to subjects of an investigation the fact that the corporation is inquiring into their conduct, including the information gathered during the investigation and any conclusion reached by the company at the end of the process. This ruling, if not revised, will inevitably complicate the analysis of corporate compliance officers charged with determining how to investigate allegations of misconduct within the organization.

However, the opinion of the staff attorney in the FTC Opinion Letter has not yet been examined by the courts. It is possible that the reasoning of the FTC Opinion Letter will be viewed by a Court as flawed. Nevertheless, corporate officials should be aware that employees have an argument that they are entitled to be advised that they are being investigated, to be provided the results of the investigation, and to commence an action against their employer if such disclosures are not made.

Because of the complications presented by the FTC Letter Opinion, it is now more important than ever that companies reexamine their existing compliance programs and consider the use of outside counsel to conduct internal investigations. By attempting to provide the investigation the protection provided by the attorney-client privilege, corporations may avoid the conclusions of the FTC Letter Opinion and its attendant sanctions for nondisclosure. Although it is unclear whether the attorney-client privilege and attorney work product doctrine will immunize investigations from current disclosure requirements, the respect and deference these principles have long been accorded by the courts provide the best opportunity for corporations to continue to control the confidential nature of their internal investigations.

ELECTRONIC FILINGS IN BID PROTESTS AT THE GENERAL ACCOUNTING OFFICE

By Tania Calhoun, Senior Attorney, General Accounting Office

For several months, the General Accounting Office has been conducting pilot project permitting the limited use of electronic filings ("e-filings") in its bid protest forum. Because the results of the pilot project suggest that bid protest e-filings have been helpful and well received, GAO is considering expanding the use of e-filings. During the pilot project, e-mail and e-mail attachments have been used for the purpose of transmitting only unprotected documents or communications among the parties. In addition, GAO has been accepting certain types of electronic media (primarily diskettes and CD-ROMs) with permission of the cognizant GAO attorney, where the filings do not present access problems or where any problems can be readily solved by indexing or other referencing. The main impediment to more widespread use of e-filings has been concern about whether protected material should be allowed to be transmitted, which is primarily due to concerns about security and the possible impact on third parties (that is, those who are not participating in the protest, such as other offerors, whose protected material might be transmitted via e-filing).

We anticipate that within the next several years technological advances, including widely available security measures, will lead to the use of a vehicle such as a secure, password-protected web site for purposes of filing bid protest material, including protected documents. We are in the process of meeting with representatives of courts and other fora engaged in electronic filing efforts to gather information and ideas about such a web site. In the interim, GAO is considering expanding the use of e-filings by permitting (on request and with explicit approval by the cognizant GAO attorney) the transmission of protected material via e-mail and e-mail attachments.

We invite comments from the bid protest community on this proposed expansion. We are particularly interested in hearing whether the use of e-mail for protected filings would be viewed as significantly increasing the risk of disclosure beyond the level present in the use of telefacsimile transmissions, which are currently a permitted method of transmitting protected material. In this regard, it would be helpful to hear about experiences with public key infrastructure (PKI) or other encryption tools. We would also appreciate comments addressing the considerations associated with any increased risks that third parties would be subjected to as a result of this expansion, and any suggestions concerning possible increased security measures, consent, procedural considerations, and any other matter that commenters feel should be addressed as part of this expansion.

Please submit your comments to Tania Calhoun, Senior Attorney, either by e-mail at mailto:CalhounT@gao.gov?subject=Electronic Filings, or
by conventional mail at: U.S. General Accounting Office, Room 7285,
Washington, D.C. 20548, by March 28, 2001.

U.S. Court of Federal Claims Advisory Counsel Technology Committee

Electronic Filing and Case Management Survey

At the present time the Administrative Office of the U.S. Courts ("AO") is conducting a pilot program for the introduction of Case Management/Electronic Case Files ("CM/BCF") systems in the U.S. Federal Courts. These systems would permit, inter alia, electronic filing of pleadings, electronic docketing, electronic case record management systems, as well as differing levels of electronic access to Court documents by the bar and members of the public. The AO will be bringing additional courts on line with some or all modules of these electronic systems over the next few years. The U.S. Court of Federal Claims is eligible to participate in the AO's project and over the next year must consider and determine the timing of its participation and those modules it will adopt.

In order to provide the Court information that might be helpful in determining the speed with which automation should occur and which package of technological tools would best address the Court's and practitioners' needs now and in the future, the Advisory Council to the Court is conducting a survey of the kinds of technology tools and services that the Court and practitioners now use and are likely to use in the future for the cases that will come before the Court. The quality of the responses received in this survey will assist the Court in determining its present and future needs. Please take the time to respond to the survey carefully and completely. Thank you for you anticipated cooperation in this effort.

The results of the survey will be made available for review once they are tabulated.

1. Do you currently practice in the corporate, public or private sector?

2. In what jurisdictional areas do you practice?

   Government Contracts
   Indian Claims
   Military Pay
   Patent
   Takings
   Tax
   Vaccine
   Other (please specify) ____

3. Do you have a computer for business? (Yes or No)
   If you answered "Yes," answer the following additional questions.

   A. Which operating system and version do you use? (E.g., DOS, Macintosh, Windows 95/98/NT (IBM format), LINUX, etc.)

   B. Which word processing package and version do you use? (E.g., Microsoft Word 2000, WordPerfect 9.0, etc.)

C. Which presentations/graphics packages and version do you use? (E.g., Microsoft PowerPoint 2000, Presentations 9.0, , Excel)

D. In what formats can your office write/create/download/read documents? Please specify. (E.g., Adobe Acrobat PDF, ASCII, TIFF, GIFF, Wordperfect, Word, other)

E. Can you receive and transmit documents electronically from your office computer? (E.g., e-mail, facsimile with hard copy print out, fiLc simile directly into your computer, Internet, etc.)

F. Can you run diskettes, CD ROMs on your computer?

0. Do you have a CD writer, or other ability to write CD ROMs, and/or diskette writing capability on your computer?

H. Do you have a document scanner?

I. Do you have access to e-mail? If so, which software package do you use? (E.g., Microsoft Exchange, Outlook, GroupWise, Lotus Notes)

J. Which web browser and version do you use? (E.g., Netscape Navigator 4.7 or Microsoft Internet Explorer 4.0)

K. Can you access the Internet from your computer? If so, specify whether you access the Internet via an Internet Service Provider (ISP) or modem.

L. Do you currently have a firewall or other means of protecting electronic media containing proprietary information from unauthorized access? Please specify?.

M. Do you anticipate any technology changes to the above questions within the next three years? If so, what changes do you anticipate?

4. If you do not now have a computer, do you plan on acquiring one within the next three years?

5. If the Court instituted electronic filing would you be able to utilize this capability?

A. Filing on line

B. Filing using electronic media such as a CD ROM to exchange pleadings and documents?

C. Would you be interested in doing so?

6. Would you make use of a Court-created website from which the parties to litigation could access the docket, pleadings, other case-specific documents?

   Would you be more likely to do so if the website were secure and password protected?

7. Would you make use of a Court-created website from which members of the bar could access Court docket sheets and unprotected pleaadings and documents?

8. Would you make use of a Court-created website from which members of the public could access Court documents not otherwise subject to a protective order?

9. If the Court created a website from which Court docket sheets and unprotected pleadings could be accessed, would you utilize this capability if it were free?

   If you had to pay an access fee of less than $10? Less than *$50?* More than *$50?*

10. Are there any other documents that you would like to see accessed through a Court website?

11. Should the Court conduct an Electronic Case Filing (BCF) Pilot Project?

12. Should the Court initially use BCF to cover only those cases arising from a single agency? A specific area of the Court's jurisdiction? (Please explain your answer.)

13. The Government has instituted initiatives to reduce the amount of paper in government. To that end, the Government now engages in paperless procurements, on line contract administration and correspondence, electronic tax return filing, etc. With this in mind, identify potential sources of evidence for your cases. For each of the following, indicate whether it is likely, unlikely, or could possibly be a source of evidence for a case that could be filed at the Court right now? For a case that might be filed three years from now.

	Current Potential/Actual Source of Evidence	Three Years From Now
Paper documentation	____________________	________________
Live Witnesses	_______________________	__________________
Electronic media		

Electronic databases _______________________ __________________
Paperless procurements ________________________ ___________________
Paperless contracts ________________________ ___________________
E-mail __________________ _______________
Electronic files _________________________ ____________________
CD ROMs ________________ _____________
Diskettes _________________________ ____________________
Tapes _____________________ _________________
Powerpoint presentations
Excel spreadsheets
Reverse auction database _______________________ __________________
Other ____________________ ________________ Physical exhibits _________________________ ___________________ Other ____________________ ________________

14. Do you think proprietary information should be transmitted to the Court and/or the parties via electronic means?

15. Do you think the Court should permit the filing of CD ROMs or electronic documentation with hotlinks to cited documents, exhibits, cases?

16. Should the Court provide the parties with computer access in the courtroom? A digital camera? Optical scanning and retrieval system? Real time court reporting? Videoconferencing for trial/hearing purposes?

17. Have you had experience with the use of PKI (Public Key Infrastructure) or other encryption tools to protect electronic information? If so, please specify the type of encryption tool you have used?

18. Would you like to see the Court and the COFC Bar hold an open discussion on this topic before a decision is made?

19. Have you had any experience with electronic filing and case management? If so, please describe your experience and indicate whether you thought the technology helped or hindered the litigation.

OPTIONAL INFORMATION

Name:
Telephone

Number:____
E-mail:

Please forward your completed survey to Clarence Kipps, Chair, U.S. Court of Federal Claims Advisory Counsel, do Miller & Chevalier, *655* 15th Street, N.W., Suite 900, Washington, D.C. 20005-5701.

If you have any questions regarding the survey, please contact Susan Warshaw Ebner, Chair, U.S. Court of Federal Claims Technology Committee (sdwebner@aol.com or (202) 383-*7145).*

TREASURER'S REPORT

Richard A. Gallivan

BCA Bar Association
Statement of Financial Condition
For the Period Ending March 15, 2001

Beginning Balance as of 1/15/00		$25,502.23
Fund Income:		
al Meeting:	$2250.00	
Total Fund Income:	$1875.00	
Subtotal		$29,627.23
Fund Disbursements		
Annual Meeting :	11236,41.40	
Stamps/envelopes	$244.50	
Stamps	$ 68.00	
The "Clause"	$ 376.00	
Directory	$ 1664.96	
Directory Mailing	$ 406.02	
Total Fund Disbursements:	$13996.09	
Ending Cash Balance	$15,631.14	